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C O N F I D E N T I A L SECTION 01 OF 02 YEREVAN 001537

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TAGS: ENRG EPET PREL AM
SUBJECT: GAZPROM MOVING TO TAKE CONTROL OF IRAN-ARMENIA PIPELINE

REF: A. YEREVAN 492
¶B. YEREVAN 631
¶C. YEREVAN 900
¶D. TBILISI 2850
¶E. TBILISI 2746

Classified By: EconOff E. Pelletreau for reasons 1.4 (b,d).

SUMMARY

¶1. (C) Russian energy giant Gazprom strengthened its hold over the Armenian energy sector yesterday when it purchased all of the additional shares ArmRosGazprom (ARGP) issued to raise capital for the purchase of the Fifth Unit of the Hrazdan Thermal Power Plant (Hrazdan 5). With the share purchase, Gazprom's stake in ARGP increased from 45 percent to 58 percent. Even prior to the sale, Russian interests held a controlling stake in ARGP with Gazprom and Itera jointly holding 55 percent of the shares. The remaining 45 percent was owned by the Armenian Ministry of Energy. Despite official denials, it is likely that in the coming days control of the Armenian portion of the Iran-Armenia gas pipeline will be turned over the ARGP, further solidifying Russian control over the Armenian energy sector. END SUMMARY

SEALING THE DEAL ON HRAZDAN 5

¶2. (C) Gazprom's recently announced decision to purchase the additional ARGP shares is the final step in the long-anticipated sale of Hrazdan 5 (refs A, B and C). The deal, which has been in the works since April, leaves Gazprom with a controlling stake of 58 percent of ARGP. Armen Arzumanyan, an Armenian energy expert who is chief of party for USAID contractor PA Consulting told us that the proceeds from the sale would likely be used to fund a gas subsidy for consumers which the GOAM has pledged to maintain until January 1, 2009. (NOTE: Armenia parliamentary and presidential elections are scheduled for 2007 and 2008. END NOTE.)

IS THE PIPELINE PART OF THE DEAL?

¶3. (C) Armenian media reports suggest that Gazprom plans to purchase the Iran-Armenia gas pipeline (now under construction) as well. These rumors have circulated since June, when Gazprom Deputy Chairman Alexander Ryanazov informed shareholders that the company planned to acquire the pipeline (ref C). Armenia's Prime Minister and Defense Minister have both publicly denied that there is an agreement to sell the pipeline directly to the Russians, while leaving

open the possibility of some other sort of transfer. Last week, Director of ARGP Karen Karapetian told the press that he had asked the GOAM to consider granting ARGP a management contract for the pipeline, which he argued made sense because, as it is currently designed, the pipeline must connect to the ARGP distribution network. Armenia's Prime Minister seems to support this proposal and has been quoted in the press as saying it would be "illogical to have two gas distribution networks in Armenia." Arzumanyan theorized that the GOAM had agreed to transfer control of the 40 km Meghri-Kajaran section of the Iran-Armenia pipeline to ARGP in April as a (heretofore undisclosed) part of the Hrazdan 5 agreement. That would explain Gazprom's willingness to pay USD 250 million for the plant and agree to invest an additional USD 180 million in upgrades when construction of a similar plant from scratch would cost approximately USD 220 million.

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IRAN PIPELINE FALLS SHORT OF REPLACEMENT CAPACITY, FOR NOW
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¶4. (C) The first leg of the Iran-Armenia pipeline, 40 km from the border town of Meghri to Kajaran, is expected to become operational on December 20. Arzumanyan gave us a general overview of how the Meghri-Kajaran pipeline will integrate with the rest of Armenia's energy network. The pipeline has a 700 millimeter diameter and, given current capacity in Iran, will carry approximately 1.1 billion cubic meters (BCM) annually once completed. If Iran upgrades its capacity, the Meghri-Kajaran line could potentially carry as much as 6 BCM. Total annual gas consumption in Armenia is 1.7 BCM. In order for Armenia to benefit from the full capacity of the Meghri-Karjaran pipeline, Arzumanyan explained, it will need

to upgrade the pipeline from Kajaran to Ararat to link up to the rest of the ARGP national distribution network. The Kajaran-Ararat pipeline is in disrepair and can only carry 300 million cubic meters annually (less than 1 million cubic meters a day). Given that average consumption in Armenia during winter months is 7-8 million cubic meters per day, the gas imported through the pipeline with Iran will not be sufficient to fully replace Russian gas imports unless and until the Kajaran-Ararat pipeline is upgraded. Under Armenia's April 2006 deal with Russia for Hrazdan 5, the Russians were also given authority to upgrade the Kajaran-Ararat pipeline, but it is not yet clear that the Russians are willing to make the necessary USD 120 million investment to do so.

COMMENT

¶5. (C) While Gazprom's increased holding in ARGP certainly made headlines, energy sector insiders already considered ARGP to be Russian controlled and believe the share purchase was merely the mechanism for implementing the sale of Hrazdan ¶5. The bigger story will be if and when the GOAM transfers the Mehgri-Kajaran pipeline to ARGP, effectively giving control to the Russians while remaining true to earlier statements that there would be no direct sale. Russian ownership of the Iran-Armenia pipeline would diminish the project's value for energy diversification, in that it leaves Russia in control of Armenia's gas supplies. However, the Iran-Armenia pipeline, even if it is owned by Russian interests, could help to mitigate the impact on Armenia if Russia decides to cut off gas exports to Georgia, as it has before (refs D and E), which currently would leave Armenia out in the cold.
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